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# Before the FEDERAL COMMUNICATIONS COMMISSION Washington, D.C. 20554

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In the Matter of	)	FEDERAL COMMUNICATIONS COMMISSION OFFICE OF THE SECRETARY
Implementation of the Pay Telephone	)	
Reclassification and Compensation	)	CC Docket No. 96-128
Provisions of the Telecommunications	)	
Act of 1996	)	

# PAGING NETWORK, INC.'S COMMENTS ON REMAND ISSUES

### PAGING NETWORK, INC.

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### **SUMMARY**

Given a second chance by the Court of Appeals to correct the flawed local coin approach to compensation, the Commission should not repeat the mistake it made the first time around. The purpose of this remand is not to garner evidence that might prop-up the local coin approach. Instead, the only way to satisfy the Court's remand is to reconsider and reject the use of local coin rates, in any manner, to derive a compensation amount for access code and subscriber 800 calls.

PageNet shows in these comments that both of the underlying premises to use of the local coin rate are fundamentally wrong. There is no evidence that costs and rates converge in the local coin market. Indeed, the virtual uniformity of coin rates at \$.35, despite expected variances in costs between phones and between PSPs, illustrates that competition in payphone services does not produce competitive local rates. Second, the markets for local coin calls and for subscriber 800 and access code calls contain different market actors and different market characteristics. Therefore, the Commission cannot establish the relevant nexus between the local coin rate and the market rate for either subscriber 800 calls or for access code calls.

In order to correct its errors, the Commission must abandon the local coin approach and lower compensation substantially. It should use a reasonable, cost-based approach to compensation, and should apportion the compensation amount on a per-increment basis, as PageNet argued in its pending Petition for Reconsideration.

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## PAGING NETWORK, INC.'S COMMENTS ON REMAND ISSUES

Paging Network, Inc. ("PageNet"), on behalf of its operating subsidiaries, respectfully submits the following comments regarding issues remanded by the United States Court of Appeals in the above-captioned proceeding. For the reasons explained below, the Commission should abandon its effort to tie payphone compensation to the local coin rate. Instead, should lower compensation substantially to reflect the costs of originating each type of compensable call. In addition, the Commission should recognize that subscriber 800 calls are different from access code calls and, in particular, that short duration calls are different from longer payphone calls. Accordingly, the Commission should grant PageNet's pending Petition for Reconsideration and adopt compensation on a per-increment-of-use basis, rather than a per-call basis.

Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding, DA 98-1198 (rel. June 19, 1998) (*Public Notice*); see MCI Telecommunications Corporation v. FCC, slip op. (D.C. Cir. No. 97-1675, May 15, 1998) (*Payphone II*).

#### I. BACKGROUND

This is now the Commission's third attempt to establish a reasonable mechanism to ensure fair compensation to payphone service providers ("PSPs") for payphone-originated calls. In two separate appeals, two panels of the D.C. Circuit reversed the Commission's attempt to establish "market-based" compensation for access code and for subscriber 800 calls using the local coin rate as a surrogate. In addition, several petitions for reconsideration of the *Second Report and Order*<sup>2</sup> are pending, including PageNet's request that the Commission address differences among compensable calls. The Commission can and must correct the windfall it granted in this proceeding, and adopt a reasonable compensation plan in its place.

In the initial *Payphone Orders*,<sup>3</sup> the Commission prescribed compensation at an amount equal to a presumed market rate for local calls (\$.35). The Court of Appeals vacated and remanded this decision, finding subscriber 800 and access code compensation "inexplicably tied to a local coin rate." Noting that the record was "replete with evidence" to the contrary, the Court rejected the Commission's sole ground proffered for connecting the two rates – that the costs of coin calls and compensable calls are similar. It vacated and remanded the compensation rate, with instructions for the Commission to set a new rate.

Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Second Report and Order, 13 FCC Rcd 1778 (1997) (Second Report and Order).

Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Report and Order, 11 FCC Rcd 20,541 (1996), Order on Reconsideration, 11 FCC Rcd 21,333 (1996).

Illinois Pub. Telecom. Ass'n v. FCC, 117 F.3d 555, 564 (D.C. Cir. 1997) (Payphone I).

<sup>&</sup>lt;sup>5</sup> *Id.* at 563.

The Commission made only slight changes to its compensation amount as a result of the *Payphone I* remand, however. Purporting to address the differences in cost between a local coin call, on the one hand, and subscriber 800 and access code calls, on the other, the Commission reduced the compensation amount to \$.284.6 Critically, however, the decision on remand continued to rest on the premise that the local coin rate is a surrogate for both subscriber 800 and access code compensation. While abandoning the claim that the costs of these calls are "similar," the Commission nevertheless tied compensation to the local coin rate because "the majority of the costs associated with a payphone are joint and common costs."

As with the initial compensation plan tied to the local coin rate, the Commission's revised compensation amount fared no better than did the original rate. After consideration of the rationale for using the local coin rate, the *Payphone II* Court found the derivation of the \$.284 rate "plainly inadequate." In adjusting the rate a few pennies, but failing to reconsider the premises of its compensation plan, the Commission had completely missed the meaning of the initial remand. As the Court explained, "The Commission never explained why a market-based rate for coinless calls could be derived by subtracting costs from a rate charged for coin calls." This approach is an apples to oranges comparison when the two quantities being compared are logically independent of one another. Yet the Commission blithely assumed the connection without ever taking the steps necessary to establish that one existed.

<sup>&</sup>lt;sup>6</sup> Second Report and Order.

<sup>7</sup> *Id.* at ¶ 42.

<sup>8</sup> Payphone II, slip op. at 11.

Id.

<sup>&</sup>lt;sup>10</sup> *Id.* 

Given a second chance to correct its reasoning, the Commission should not repeat the mistake it made the first time around. The purpose of this remand is not to garner evidence that might prop-up the local coin approach. The problem with payphone compensation is much more fundamental than that default compensation is off by a few pennies, or that the FCC's order contained insufficient clarity in its explanation. Instead, the futile attempt to base access code or subscriber 800 compensation on the local coin rate should be abandoned. Because there are three independent markets – a local coin market, an access code market and a subscriber 800 market – any attempt to tie compensation to a single rate will fail.

The Commission should also take this opportunity to correct the erroneous assumption that all compensable calls are similar. As PageNet showed in its Petition for Reconsideration, rather than prescribing a flat-rate amount per-call, the Commission should require compensation to be paid per-increment of use (e.g. in 6-second increments), subject to a cap to prevent excessive compensation payments. It is manifestly unfair -- and therefore contrary to the Commission's legal responsibility to prescribe "fair compensation" -- to require PageNet and similarly situated 800 subscribers to pay flat-fee compensation (particularly compensation in the ballpark of 28 cents) for 30 seconds of 800 service that itself costs less than a nickel.

### II. THERE IS NO EVIDENCE THAT COSTS AND RATES CONVERGE IN THE LOCAL COIN MARKET

The first assumption in the Commission's local coin approach to compensation is that the local coin rate is itself a competitive rate. As the Court recognized, if costs and rates do not converge in the local coin market, then the foundation of the Commission's entire approach crumbles. Taking heed from the Court's express criticism, the *Public Notice* asks whether the local coin rate reflects competitive market conditions and whether costs and rates converge in the coin call market.<sup>11</sup>

Freed by the FCC from regulatory oversight, PSPs have uniformly increased their local coin rates to \$.35. All major PSPs quickly raised their rates to this level, with the only difference in rates apparently resulting from practical difficulties associated with reprogramming so many phones at once. However, if it were true that costs and rates converged in the local coin market, the local coin rate would not be uniform across the country. Instead, some areas would have higher payphone rates than others, and some PSPs would offer lower coin rates than PSPs with different cost structures. Empirical evidence is lacking for this proposition.

For example, there is no evidence that local coin rates vary by geographic region of the country. Cost factors such as payphone line costs, installation costs, and the frequency of maintenance can vary from region to region. Moreover, differences in the density of payphones or the proximity of substitutes for local calls should also affect payphone rates on a phone-by-

Public Notice at 2.

See, e.g., Warren Telecom Regulatory Monitor, Nov. 17, 1997 (discussing increases by Bell Atlantic, GTE, Southwestern Bell, BellSouth and PacTel).

phone basis. Factors such as these should result in significant cost variances among payphones located in different regions, even where a single company operates in multiple regions. If the coin rate were reflective of these variances, it too would be higher in some regions and lower in others. The fact that the coin rate has uniformly increased to \$.35 suggests that these variances are not being reflected in local coin rates.

Similarly, costs should vary from one PSP to another. PSPs make different choices among the types of payphone equipment to use (with attendant cost difference) and among the types of locations to serve (indoor vs. outdoor; airports, etc. vs. single phone installations). Each of these choices should result in different cost structures among PSPs. Further, significant cost factors such as maintenance and field service costs can be highly influenced by the cost of labor. To the extent that PSPs have higher or lower than average labor costs, they should encounter different overall costs. As a result of these differences, one would expect some PSPs to have a cost advantage over their competitors. If costs and rates converged, one would expect such differences to be reflected by some PSPs having lower overall coin rates, but there is no evidence that this is the case in the local coin market.

Instead, it appears that these differences are reflected in other aspects of competition among PSPs. Most likely, these cost differences are being reflected in the commissions that they offer to location owners for the right to install a payphone. That is where one sees the variation among providers or locations, not in the local coin rate.

# III. THERE ARE THREE, INDEPENDENT MARKETS FOR THE RELEVANT PAYPHONE CALLS

Even if it were true that the local coin rate reflected the costs of local coin service, it is not the case that the rate is a surrogate for access code or subscriber 800 compensation. To the contrary, there are three distinct markets – a local coin market, an access code market and a subscriber 800 market. Therefore, not only is it error to assume that the local coin rate reflects access code and subscriber 800 costs, but it also is error, as PageNet showed in its Petition for Reconsideration, to assume that the access code and subscriber 800 markets are similar for compensation purposes.

## A. Local Coin Calls are Different from Both Subscriber 800 Calls and Access Code Calls

The first and most significant difference between the local coin market, on the one hand, and both the subscriber 800 and access code markets, on the other, is in the composition of the market participants. In the local coin market, the PSP, as seller, offers an end-to-end service to a caller, and posts the price applicable to that service. The caller in this situation always is the buyer of the service, and will make his or her buying decision based on a number of factors, including the price for the call, the availability of change, and the convenience of using the phone at that time. Critically, at the time of the decision to place a local call, the buyer knows the rate to be charged and has the ability to determine on a case by case basis whether to place the call (and therefore incur the charge).

In the subscriber 800 market, by contrast, the market players and market dynamics are very different. Here, the PSP is not the provider of an end-to-end telecommunications service; but only a provider of one portion of the call. The buyer of a subscriber 800 service is not, however, the caller placing the call. Indeed, for subscriber 800 calls, the buyer is never the caller, but is always the party on the receiving end of the call. In this situation, the caller is indifferent to the location at which the call originates, because it is the called party that pays for the call. The 800 subscriber, by contrast, often does not know where the originating location is, and has no control over the price that is being charged from the payphone. The 800 subscriber cannot respond to market signals in the same way that the caller can in a local call.

For access code calls, the differences are not as pronounced, but the market dynamics nevertheless do not operate in the same way as in local calls. The buyer can be the calling card holder (in the case of a card call), <sup>13</sup> the called party (collect calls) or a third party (third number billed calls). In contrast with the operation of the local coin market, the caller making an access code call is not subject to the same price signals as when the caller places a local call. First, where the caller is not the buyer, he is not price sensitive at all. The true buyer in this situation does not have the same ability as the local caller does to control when and where the call originates. <sup>14</sup> Second, even when the caller is also the ultimate buyer, the market dynamics are changed by the indirect nature of the payphone charge. The caller does not pay the PSP directly,

The card holder can be, but is not always, the caller.

The buyer does not have the ability to block calls on a case by case basis, and thus cannot make the same choices as a caller can. Even where the buyer can reject all payphone calls, the "all or nothing" choice available to the buyer does not mirror the choice a local coin caller can make.

may not be aware of the charge, and is not affected by the same factors that are present in local calling.

Due to these differences, it is unreasonable to conclude that the local coin market will be a surrogate for either the subscriber 800 or access code market. The markets each of these types of calls will not operate in the same manner. Changes that can affect the local coin market, such as the availability (or lack thereof) of sufficient coins, will not affect the subscriber 800 market or the access code market. Therefore, the local coin market will not reflect a market for an access code call or for a subscriber 800 call. Because the necessary connection does not exist, the local coin rate cannot be used to determine compensation for subscriber 800 or access code calls.

#### B. Subscriber 800 Calls are Different from Access Code Calls

Just as it is inappropriate to equate local coin calls with access code or subscriber 800 calls, it is inappropriate to treat all access code and subscriber 800 calls similarly when the record reflects there are substantial differences among such calls. There are dispositive cost differences, as well as market differences, both between access code and subscriber 800 calls as well as among subscriber 800 calls.

As PageNet showed in its Petition for Reconsideration, access code and subscriber 800 calling are two different services, with different usage and cost characteristics. Access code calls provide a caller with the ability to direct calls to any terminating telephone number and to bill for that call in a number of ways (e.g., calling card account, collect, third-number, etc.). Access code calls typically are billed on an increment of use basis, but with an up-front call setup charge that varies according to the type of billing provided. Subscriber 800 service, on the other hand,

provides the caller the ability to reach a particular person or entity, without charge to the caller. The terminating location on an 800 call is chosen by the 800 subscriber, who agrees in advance to pay the communications costs of the call (and typically receives a bulk discount over 1+ calling). 800 service is billed purely on an increment of use basis, with six-second billing the norm. The services provided by the underlying subscriber determines the average call length each subscriber will experience. As a result, the duration of the different types of subscriber 800 calls will coincide only by fortuity.

Further, in general, subscriber 800 calls tend to be shorter in duration than are access code calls. PageNet, for example, is among the largest users of 800 services in the country, assigning 800 numbers to its paging and voicemail subscribers for access to their accounts and to originate pages or other communications. Its average holding time, for the tens of millions of messages it completes for customers each month, is under 30 seconds. Linkage of both the subscriber 800 and access code rates to the local coin rate fails to take these differences among compensable calls into account.

### IV. THE COMMISSION SHOULD PRESCRIBE COST-BASED COMPENSATION

Rather than engaging in another ultimately futile attempt to tie together independent markets, the Commission should revise its course and prescribe compensation on a new basis. It should prescribe reasonable compensation based on the cost of originating these calls. In

Moreover, 800 numbers are used by subscribers for a vast array of purposes, created substantial differences even within the subscriber 800 category of calls.

PageNet 1997 Remand Reply Comments at 13.

addition, the Commission must ensure that its compensation plan accounts for the differences among compensable calls, such as by prescribing a measured rate of compensation.

The best way to set a fair compensation amount is for the Commission to use reliable and representative cost information. Cost-based compensation is fair, is consistent with Section 276, and will promote the widespread deployment of payphones and of payphone services to the public.

It is critical, however, that calculation of payphone costs reasonably reflect the costs of the payphone industry as a whole, not a small minority of the industry. Failure to represent the entire payphone industry (and in particular, the lower costs of the largest industry players) constituted the principal error in the *Second Report and Order's* alternative "bottom-up" cost for payphone calls. The Commission reached its inflated cost estimate only by systematically ignoring LEC cost data and by inflating costs to reflect a hypothetical "low volume" payphone. Neither adjustment appropriately reflects the costs of the payphone industry as a whole.

Therefore, the Commission rightly declined to rely upon this alternative calculation. If the Commission conducts a cost analysis on remand, it should reject its previous calculation and conduct it anew using proper data and proper assumptions.

Critical to a proper cost analysis is the inclusion of data representing the largest LECs, which operate approximately 75 percent of the payphones in the nation. These LECs, many of which are several times larger than the largest independent PSP, also appear to be more efficient

Second Report and Order at ¶ 99, 118.

<sup>18</sup> *Id.* 

than the average independent PSP, as is amply demonstrated by the Sprint LECs' costs, <sup>19</sup> by Bell Atlantic's cost of operating payphones in Massachusetts, <sup>20</sup> and by SBC's analysis of its Southwestern Bell Telephone payphone division. <sup>21</sup> Using this data, the Commission should set a cost-based compensation amount of no more than \$.15 per call.

Furthermore, once the costs of these calls is determined, the compensation amount should be apportioned fairly among all compensable calls. It makes little sense to suggest that all compensation payors should pay the same amount regardless of the duration of their usage. For example, it is unfair to require PageNet to pay compensation in the neighborhood of 28 cents (or any lower amount set in this proceeding) in order to receive less than 30 seconds of 800 service costing less than a nickel. Yet that is precisely the effect of the flat-rated compensation plan adopted in the *Second Report and Order*.

As PageNet has shown previously, concerns over the equity of flat-rate compensation led the Commission originally to propose a measured compensation system in its Docket 91-35 compensation plan.<sup>22</sup> Ultimately, the Commission abandoned the idea of per minute compensation out of a concern that tracking of the calls would be too difficult.<sup>23</sup> However, now

Sprint 1997 Remand Reply Comments at Attachment 1.

Sprint 1997 Remand Comments at Exhibit A.

AT&T Petition for Reconsideration at Robinson Aff., Attachment I.

Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, Notice of Proposed Rulemaking, 6 FCC Rcd 1448, 1450 (1991) (proposing to base compensation on the "number of calling minutes generated by access code calls from . . . public payphones") ("Docket 91-35 NPRM").

Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, Report and Order and Further Notice of Proposed Rulemaking, 6 FCC Rcd 4736, 4747 (1991).

that carriers have developed the ability to track compensable calls, the Commission should reconsider its decision and adopt a measured use approach.

#### **CONCLUSION**

For the foregoing reasons, the Commission should reject its previous attempts to based access code or subscriber 800 compensation on the local coin rate. The local coin rate does not converge upon costs, as it would in a competitive market, and in any event is an improper surrogate for either the access code or subscriber 800 markets. On remand the Commission should prescribe cost-based compensation using data representative of the LECs' costs in providing payphone services. Moreover, the Commission should prescribe per-increment of use compensation instead of per-call compensation in order to account for differences among compensable calls.

Respectfully submitted,

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